U.S. Senate
Republican Policy
Committee

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Conference Report Highlights

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Highlights of the Conference Report to accompany S. 900, Financial Services Modernization Act of 1999

NOTEWORTHY

- The Majority Leader hopes to bring the conference report to accompany S. 900 to the floor this week.
- S. 900 is the most sweeping financial services legislation expected to be enacted in decades. An historic measure, it will completely overhaul the financial industry by overturning outdated laws that came into existence during the Depression.
- According to Senate Banking Committee Chairman Gramm, S. 900 will make an array of financial services available to every American consumer that will provide lower prices and one-stop shopping at financial supermarkets across the country.
- S. 900 will completely modernize the financial service industry by eliminating the barriers preventing banks, insurance companies, and securities firms from affiliating; this will result in increased efficiency, reduced costs, and increased financial services available to every consumer — whether in the market for a personal loan, a mortgage, or to enhance an investment portfolio.
- Chairman Gramm predicted the conference report would pass both houses of Congress by large margins and be signed by the President.

Highlights

S. 900 provides for the affiliation among banking and other forms of financial services and commercial enterprises. The following are the conference agreement's main areas of reform:

- **Financial Holding Companies.** S. 900 repeals the anti-affiliation provisions of the 1933 Glass-Steagall Act to allow for the merger of banking, insurance, and securities organizations under the existing bank holding company structure. The conference agreement allows bank holding companies to engage in activities that are "financial in nature or incidental thereto." The bill lists the expanded activities considered financial in nature, and includes insurance and securities underwriting and merchant banking, among others. The bill establishes the Federal Reserve Board as the umbrella holding company supervisor, while State and other federal regulators will continue to oversee the activities within affiliates that they traditionally regulate.

National Bank Subsidiaries. S. 900 contains provisions allowing national banks and insured state banks to engage, through "financial subsidiaries," in certain financial activities permissible for affiliates of financial holding companies. These provisions reflect the compromise reached between the Federal Reserve Board and the Treasury Department. Activities prohibited for a financial subsidiary are merchant banking, insurance underwriting, real estate development, and real estate investment. However, the merchant banking prohibition may be sunsetted after five years if the Federal Reserve Board and the Treasury Department jointly agree that the activity is permissible. In order to engage in permissible activities through a financial subsidiary, a national bank must be well capitalized and well managed, have in place specific policies and procedures to safeguard the bank, and receive the approval of the Comptroller of the Currency. A national bank that is among the 50 largest insured banks in the United States must have an issue of outstanding long-term debt rated in one of the three highest rating categories by an independent rating agency in order to establish a financial subsidiary. A national bank that is among the next 50 largest banks in the United States must either meet the rating described above or a comparable test jointly agreed to by the Federal Reserve Board and the Treasury. No rating requirement applies to national banks that are not among the 100 largest banks in the United States. The total assets of all financial subsidiaries of a national bank may not exceed 45 percent of the parent bank's consolidated assets, or $50 billion, whichever is less. The parent bank is required to deduct from its capital the equity investment made in a financial subsidiary.

State Law and Insurance Sales. While states have always been the primary regulator of insurance sales and underwriting, some states have used their regulatory authority to discriminate against insured depository institutions. S. 900 provides for the state regulation of insurance, subject to a standard that no state may discriminate against persons affiliated with a bank. National banks may sell title insurance in a state but only to the extent and under the same restrictions that the state laws permit a state bank to sell title insurance. Title insurance underwriting activities conducted by national banks as of the date of enactment of the Act are grandfathered. Going forward, however, title insurance underwriting may be conducted only through an affiliate of the national bank.

Community Reinvestment Act. S. 900 makes a number of changes to CRA. Providing sunshine for the first time, the bill requires full public disclosure of CRA agreements where one party is an insured depository institution or affiliate and the other is a nongovernmental person or entity. The insured depository institution will make annual reports to its regulatory agency. The nongovernmental person or entity may file its annual report directly with the regulatory agency for the insured depository institution, or with the insured depository institution, which must then promptly forward the report to the regulator. The conference agreement also provides CRA regulatory relief to small banks and savings and loans with assets of no more than $250 million. If these small institutions received an outstanding rating at their most recent CRA exams, they will not receive another exam for five years. If they received a "satisfactory" rating, then they will not receive an exam for four years. The conference agreement also prohibits a bank holding company from becoming a financial holding company if any of its banks did not receive at least a "satisfactory" rating in its most recent CRA exam. Further, no financial holding company or bank, through a financial subsidiary, may begin new activities authorized under this bill if the bank or its affiliated banks received less than a "satisfactory" rating at its most recent CRA exam. Additionally, no divestiture or limitation of activities could occur as a result of a less than "satisfactory" rating.

- **Unitary Thrifts.** Unitary thrifts will be prohibited from merging with commercial businesses after May 4, 1999. Existing unitary thrift holding companies may only be sold to financial companies.

- **Privacy Protections.** The conference agreement requires annual disclosure by all financial institutions of their privacy policy regarding the sharing of non-public personal information with affiliates and third parties. The financial institutions must give consumers an opportunity to "opt-out" of the sharing of non-public information with non-affiliated third parties.

- **Federal Home Loan Bank System Modernization.** The conference agreement would change current law to make the Federal Home Loan Bank System membership voluntary for savings and loan associations. The bill also expands the types of assets which can be pledged as collateral for advances for certain institutions. The bill would permit banks with less than $500 million in assets (community banks) to pledge small business and agricultural loans as collateral and to use the advances to fund small business, small farm, and small agribusiness lending.

Background

S. 900 is an historical measure that was some 25 years in the making but whose provisions were becoming inevitable by globalization of financial services, developments in technology, and changes in the capital markets that have rendered existing laws obsolete. Current laws block affiliations between and among banks, securities firms, and insurance companies. Banks are further precluded from offering most securities and insurance products.

The current constraints date back to the 1933 Glass-Steagall Act (which required the separation of commercial banking and investment banking) and the 1956 Bank Holding Company Act (which required the separation of banking and insurance). The intent of these laws was to prevent banks from "gambling" on risky ventures with FDIC-insured deposits. Originally intended to protect the financial system by insulating commercial banking from other forms of risk, these laws now hamper the ability of financial institutions to diversify their products. By limiting competition, the outdated statutes also reduce incentives to develop new and more efficient products and services. S. 900 tears down these outmoded barriers and opens the door to the 21st century: its provisions are expected to benefit industry and consumers alike in the form of increased efficiency, decreased costs, and new products and services.

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